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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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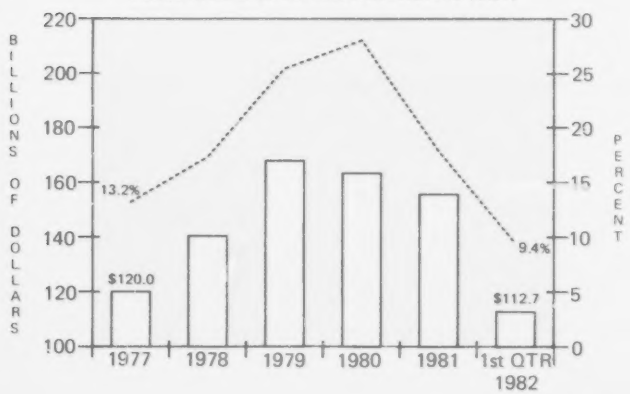
The Impact Of Recession . . .

As if the current recession had not already claimed a sufficiently heavy toll in terms of widespread joblessness, depressed household and farm incomes as well as personal and small business bankruptcies, it now appears that corporate profits are becoming one of the biggest casualties of all. Confronted with the challenges of lackluster final sales due to recession, weak productivity growth, lofty borrowing costs and a rapidly emerging climate of disinflation, U.S. corporations have been taking it on the chin when it comes to earnings performance. And when you consider that the quality of earnings has been soggy at best, being largely dependent on temporary inventory profits and inadequate depreciation allowances, an even bleaker picture emerges.

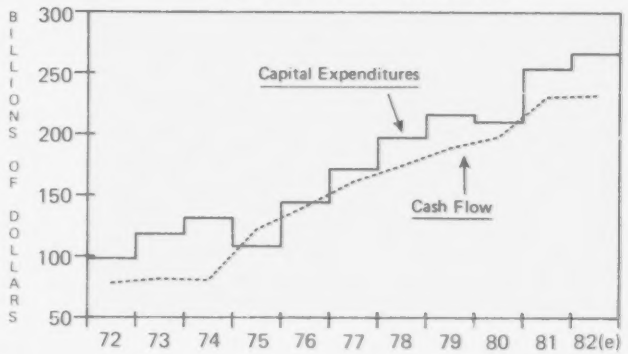
For example, preliminary estimates by this Bank suggest that before-tax profits fell by almost $50 billion during the January-March period to a seasonally adjusted $165 billion annual rate. That's a plunge of more than 22 per cent quarter-over-quarter. If these numbers hold up, it would be the largest quarterly profits drop posted in the postwar

CHART I
AFTER-TAX CORPORATE PROFITS (BAR) VS. INVENTORY PROFITS AS % OF AFTER-TAX PROFITS (DOT)



era, in both absolute and relative terms—not to mention the second quarterly decline in a row. Even compared with depressed year-earlier levels, this year's estimated first quarter earnings performance was abysmal, skidding a huge 35 per cent when measured on a year-over-year basis. After-tax earnings also fell, by approximately $30 billion during the quarter, to a seasonally adjusted $113 billion annual rate.

CHART II
NONFINANCIAL CORPORATIONS:
CAPITAL EXPENDITURES VS. CASH FLOW



This earnings plunge comes on top of the already large drop registered in the fourth quarter of 1981. At that time, with profitability deteriorating in such industries as petroleum, steel, autos and airlines, before-tax corporate earnings slid $21.6 billion to a seasonally adjusted $213 billion annual rate. Putting these results together brings the two-quarter earnings drop to a record $70 billion, paling by comparison its nearest rival for this dubious honor—the $35 billion, or 25 per cent, decline in before-tax profits which occurred during the last two quarters of the 1973-75 recession.

. . . And Disinflation . . .

Besides such factors as sluggish final sales and further escalations in labor and financing costs, first quarter earnings were depressed by disinflation, for there was a steep drop in the size of inventory profits. While many businesses have for some time now been finding themselves increasingly unable to pass along cost increases by boosting product prices, they are now finding that the growth of inventory profits, which had for so long masked a serious erosion of earnings quality by maintaining their size, has ceased. Such profits, which arise from inflation-driven gains in the value of inventories

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held in stock, have now begun to shrink, producing just the opposite results: boosting the quality slightly—but at the expense of deflating the overall size of earnings.

Whereas inventory profits had run at a seasonally adjusted $40 billion annual rate in the first quarter of 1981 (comprising just about one-quarter of total after-tax profits), by the first quarter of 1982, with inventories pared and inflation rates subsiding, such profits were estimated to be running at a seasonally adjusted $10 billion annual rate. At this level, they comprised less than ten per cent of total after-tax earnings. And since after-tax earnings dropped by about $60 billion between these two periods, fully one-half of this decline can be traced to the impact of the sharp deceleration in the rate of inflation on inventory profits. (See Chart I.)

. . . Spells Trouble . . .

The virtual elimination of this inflation "dividend," accompanied by another deterioration of basic profitability, served to magnify the widespread existence of corporate illiquidity. For even after adjustment for inventory gains, corporate profits nose-dived. With nonfarm business sector hourly compensation rates advancing at an 8.4 per cent seasonally adjusted annual rate in the first quarter compared with quarter-earlier levels and productivity rising only slightly, unit labor costs continued their ascent. They shot up at an 8.1 per cent seasonally adjusted annual rate during the January-

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 4/21/82	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	138.553	+ 3.950	+ 7.172
Loans to Depository Inst.	1.659	+ .322	+ .795
Float	2.339	– 1.199	– 1.179
Total Reserve Bank Credit	152.102	+ 3.403	+ 5.900
Treasury Deposits with Federal Reserve Banks	4.258	+ .632	+ .289
Currency Outside Banks	129.461	+ 1.119	+ 6.728
Member Bank Reserves:			
Required	40.250	+ 1.861	– .568
Excess (Deficiency)	.123	– .201	+ .054
Total Reserves Held	40.373	+ 1.660	– .514
Net Borrowed Reserves	1.377	+ .518	+ .731
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	91.167	– .593	– 9.424

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1	454.5	+ 4.5‡	+ 4.8‡
M2 (March '82)	1,864.7	+ 9.3	+ 9.6
M3 (March '82)	2,235.7	+ 8.8	+ 10.5
L (December '81)	2,643.3	+ 10.3	+ 11.5

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 4/30/82	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	12.20%	12.37%	12.12%
* Federal Agencies	13.25	13.45	13.68
* Project Notes–Taxfree (46% Taxable Equivalent)	13.43	13.89	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	14.15	14.05	14.75

‡Finance Company Paper–Prime

5- 14 days	13.75%
15- 29 days	13.75
30- 59 days	13.88
60- 89 days	14.00
90-179 days	13.75
180-239 days	13.00
240-270 days	13.00

‡* Bankers' Acceptances

May	13.90%
Jun.	13.80
Jul.	13.60
Aug.	13.50
Sep.	13.35
Oct.	13.20

‡Industrial Paper–Prime

30- 89 days	14.25%
90-120 days	14.25

†Federal Funds Effective Rate 15.25%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'82	$ 2,995	$ 2,998	$ 2,853
Gross National Product (1972 Dollars)*	1st Q'82	$ 1,484	$ 1,498	$ 1,516
Percent Change, Annual Rate	1st Q'82	– 3.9	– 4.5	8.6
Change in Consumer Prices (all urban consumers)*	Mar '82	– 3.6%	2.4%	7.2%
Change in Producer Prices*	Mar '82	– 1.2%	– 1.2%	13.2%
Civilian Employment (Thousands of Persons)†	Mar '82	99,492	99,590	100,406
Unemployment as % of Civilian Labor Force†	Mar '82	9.0%	8.8%	7.3%
Personal Income*	Mar '82	$ 2,525	$ 2,514	$ 2,340
Leading Indicators Composite Index (1967=100)†	Mar '82n	124.4	125.0	135.8
Industrial Production Index (1967=100) †	Mar '82	141.2	142.3	152.1
Net Change in Consumer Installment Credit†	Feb '82	$ 0.08	$ 0.44	$ 1.85
U.S. Merchandise Trade Balance †	Mar '82n	–$ 2.64	–$ 1.20	–$ 0.71
Plant and Equipment Expenditures*	2nd Q'82	$336.77(a)	$345.46(a)	$316.73
Private Housing Starts (Thousands of Units)*	Mar '82	947	924	1,318
New Construction Expenditures*	Feb '82	$ 230.4	$ 232.7	$ 254.5
Total Business Inventories†	Feb '82	$ 509.0	$ 511.1	$ 484.1
Total Business Sales†	Feb '82	$ 344.0	$ 336.7	$ 350.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

March, 1982 period, higher than the seven per cent gain in unit labor costs which occurred in the same period of 1981.

But in marked contrast with this year-earlier period, the business environment by early 1982 was no longer conducive to offsetting cost increases by raising product prices. In early 1981, both the "real" economy and prices were expanding either at or near double-digit annual rates. Now, with the economy still contracting (and likely to remain weak if the March decline in the index of leading economic indicators is any reliable harbinger of the future) and prices actually easing, businesses are finding that cost increases are being absorbed by the bottom line, rather than by the consumer. As a result, profits will be pressed even harder, placing corporate earnings squarely in the middle of an ever-onerous "price-cost" squeeze.

. . . For Corporate Profits

What all this means is that disinflation presents corporate treasurers with just about as much of a challenge as earlier periods of rapid price gains. The evaporation of inventory profits, together with a growing inability to pass along escalating costs, can only imply that the growth of internally-generated funds this year will remain sluggish at best, and cease at worst. This would leave another sizable gap between anticipated capital spending and corporate cash flow. In turn, this ensures that borrowing requirements will remain hefty, boding ill for any

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (4/14/82)	131,076	– 947	+21,164
New York City (4/14/82)	33,049	– 466	+ 4,655
Commercial Paper (4/14/82)	168,563	+ 486	+35,700

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/14/82)	203,683	– 606	+32,177
New York City (4/14/82)	56,948	– 269	+ 6,824

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/14/82)	477,992	– 1,251	+49,629
New York City (4/14/82)	111,715	+ 459	+10,089

Financial Markets

	Friday 4/30/82	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	12.85%	+ .29	– 2.54
180-Day Bills†	13.46	+ .50	– 1.75
Longest Bills†	13.62	+ .20	– 1.34
Recent Issues:			
13⅞s 4/30/84	13.90	+ .07	
14s 3/31/86	13.87	+ .05	
14⅝s 2/15/92	13.82	+ .22	
14s 11/15/11	13.31	+ .24	
Municipals:			
Bond Buyer- 20 Bond Index* (4/29/82)	11.97%	– .32	+ 1.03
Blue List Total ($ Million)	$ 848	+ $ 92	+ $ 38
30-Day Visible Supply ($ Million)	$1,623	– $947	– $813
Total	$2,471	– $855	– $775
Corporates:			
Moody's Aa Composite (4/29/82)	14.77%	– .02	– .03
30-Day Visible Supply ($ Million) ‡	$1,191	+ $ 53	NA
Stocks:			
Dow-Jones Averages:			
Industrials	848.36	– 13.80	– 147.23
Transportation	343.13	– 2.48	– 80.73
Utilities	113.49	– 1.10	+ 7.97
65 Stocks	333.61	– 4.16	– 49.63
Standard and Poor's 500 Stocks	116.44	– 2.20	– 15.84
N.Y.S.E. Composite Index	67.08	– 1.17	– 9.67
N.Y.S.E. Avg. Daily Vol. for Week (000's)	53,458	– 8,070	+ 1,572

* 46% Taxable equivalent 22.17%.
‡ Series redefined: Historical data not available.
† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 4/30/82	Week Ago
Overnight	15.00%	15.00%
1 month	15.00	14.88
3 month	14.88	14.88
6 month	14.88	14.88
1 year	14.63	14.63
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	14.60%	14.60%
Long Term (7 to 15 yrs.)	14.75	14.75

FOREIGN EXCHANGE SPOT RATES

New York Opening (4/30/82)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02268	44.10
Canada	.8203	1.2190
Denmark	.1259	7.9405
France	.1644	6.0835
Germany	.4285	2.3335
Italy	.0007715	1296.20
Japan	.004245	235.55
Mexico	.02154	46.43
Netherlands	.3865	2.5870
Switzerland	.5115	1.9550
U.K.	1.7889	.5590